ORIGINAL

BEFORE THE

Federal Communications Commission

WASHINGTON, D.C. 20554

In the Matter of:	)	
	)	
Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992	)	MM Docket No. 92-266
	)	
Rate Regulation	)	

COMMENTS

Arizona Cable Television Association
Falcon Cable TV
Mid-America Cable Television Association
Mt. Vernon Cablevision
Nashoba Communications Limited Partnership
Newhouse Broadcasting Corporation
Pennsylvania Cable Television Association
Prestige Cable TV
Star Cable Associates
Tele-Media Corporation
WestStar Communications, Inc.
Whitcom Investment Company

FLEISCHMAN AND WALSH
1400 Sixteenth Street, N.W.
Washington, D.C. 20036
(202) 939-7900

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SUMMARY

The Commission's Further Notice of Proposed Rulemaking asks whether the 1992 Cable Act's 30 percent penetration test for effective competition should be discounted or excluded from the Commission's rate regulations. The sole reason for such action would be to order further cable rate reductions beyond the 10 percent cut incorporated in current Commission rules.

The Commission has no statutory authority to discount or exclude the 30 percent test. In the 1992 Cable Act, Congress delineated three tests for effective competition. Cable systems meeting any one of the tests are exempt from basic cable rate regulation. Congress did not give any test more weight or significance than the others. Nor did Congress give the Commission any leeway to discount or ignore any of the tests for purposes of establishing cable rate benchmarks.

Furthermore, additional rate reductions beyond the 10 percent benchmark decrease are unnecessary. The current rate regulations are already far more sweeping than Congress intended. The Commission estimates that 75 percent of cable systems, serving 75 percent of subscribers, will be subject to rollbacks of both basic and non-basic cable rates for systems following the benchmark approach. This far surpasses prior law, as well as clear Congressional intent to subject non-basic rates only to "bad actor" regulation in individual circumstances. Moreover, the Commission's rules regarding equipment costs and second set charges, as well as the fact that the 10 percent reduction is

subtracted after rolling back all rate increases since September 30, 1992, means that many cable operators will be subject to rate reductions of well over 10 percent. "bad actor" regulation in individual circumstances. Finally, a further rate cut is not based on any evidence, and would fail to survive judicial scrutiny.

Numerous press reports have documented the devastation to the cable industry that the Commission's new rate regulations have caused. Cable stocks lost 20 percent of their value. The flow of financing and capital to cable operators has hit a brick wall. As a result, many new cable programming services desired by the public are languishing for want of capital and cable system capacity to carry them. Many planned cable plant construction and upgrades, including those necessary to build and program the "information highway" of the future, are on hold or drastically scaled back, against the wishes of Congress and millions of viewers.

Against an already gloomy financial backdrop, a further reduction in cable rates could drive many cable operators out of business. Congress never intended such a draconian result. Neither did the Commission, which specifically rejected rate reductions of over 10 percent because it realized that systems' rates may be due to high costs and it did not want to cause further financial and administrative burdens to cable operators. The Commission has established a case-by-case procedure to

scrutinize "outliers" whose rates are far above the relevant benchmark. Thus, there is no need to broadly subject all cable operators to additional rate reductions in order to ensnare individual outliers, an action which would contradict the Commission's policies articulated only two months ago.

The Commission must also realize that its actions do not take place in a vacuum. The cable industry contributes hundreds

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Consumer Protection and Competition Act of 1992 ("1992 Cable Act" or "Act").[2]

INTRODUCTION

The Further Notice seeks comment on whether one of the three statutory tests for "effective competition," the 30 percent penetration test, should be discounted or ignored in order to establish lower rate benchmarks, which would mandate further cable rate reductions beyond the maximum 10 percent rate reductions incorporated in the Commission's benchmark approach to cable rate regulation. The participants in these comments operate cable television systems of various sizes across the country, in areas ranging from rural to urban. State and regional trade associations representing cable television operators are also participants in these comments. Accordingly, Commenters' interests are directly affected by any action the Commission takes in this proceeding.

As the Commission acknowledged as recently as 1990, basic cable rate deregulation has provided great benefits to the American public in the form of a huge expansion of plant, channel capacity, and programming offerings:

> First, the cable industry has invested in expanding its plant to the point where it now offers multichannel video service to about 90 percent of Americans; before the [1984] Cable Act, cable was available to 70 percent of American

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[2]Pub. L. No. 102-385, 106 Stat. 1460 (1992), amending the Communications Act of 1934, 47 U.S.C. § 151 et seq.

> households. Second, the cable industry has significantly expanded its channel capacity -- now offering substantially greater viewing choices to the American public. . . . Third, the cable industry has launched numerous new programming services and original programs. Indeed, the number of cable programming services has doubled since the [1984] Cable Act. The cable industry has tripled annual spending on programming from $302 million to $965 million during this same period.[3]

The cable industry also provides ever-increasing contributions to the U.S. economy in terms of jobs, tax revenues, franchise fees to cities, etc.

The rate regulations adopted by the Commission on April 1, 1993 have already halted these trends by choking the cable industry's cash flow, as well as the flow of capital to the cable industry. Commenters urge the Commission not to heap additional destruction on the cable television industry and further jeopardize the financial viability of many cable operators. Any further mandated rate reductions will have a significant negative impact not only upon the future of the cable television industry, but upon the U.S. economy as a whole.

I. THE COMMISSION HAS NO AUTHORITY TO IGNORE ONE OF THE THREE [redacted]

to effective competition."[4] Under the Act, a cable system is deemed to be subject to effective competition if any one of the following three standards is met:

(1) Less than 30 percent of the households in the franchise area subscribe to cable service;

(2) (A) There are in the franchise area "at least two unaffiliated multichannel video distributors each of which offers comparable video programming to at least 50 percent of the households in the franchise area" and (B) the number of households that subscribe to such distributors, excluding the largest distributor, is greater than 15 percent of the total number of households in the franchise area; or

(3) The franchising authority is itself a multichannel video program distributor and offers its programming to 50 percent or more of the total number of households in the franchise area.[5]

Unlike the Cable Communications Policy Act of 1984,[6] the 1992 Cable Act defines effective competition rather than leaving it up to the Commission to do so. The Commission simply has no discretion to pick and choose favorites among the three effective competition tests in order to achieve a particular result. In establishing such tests, Congress undoubtedly believed that each test reflected the existence of circumstances where rate

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[4]47 U.S.C. § 543(a)(2) (1992).

[5]Id. at § 543(l)(1).

[6]47 U.S.C. § 543 (West Supp. 1989).

regulation would be unwarranted. Congress could have established a process by which, if one of the three tests were met, cable operators would need to make some further showing to demonstrate the existence of effective competition and avoid basic rate regulation. But Congress did not take any such steps. It clearly defined three separate and independent tests for effective competition and decided that basic cable rates are not subject to regulation where such competition exists under any one of those tests.

By definition, therefore, Congress believes that rates charged by systems meeting one of the effective competition tests are competitive. The Commission has no authority to decide otherwise. Congress did not choose a favorite effective competition test. It gave no test has more weight or significance than any other. Thus, the Commission has absolutely no basis to second-guess Congress and discount or ignore the 30 percent penetration test for purposes of calculating rate benchmarks.

B. The 1992 Cable Act's Effective Competition Standard Will Subject Many More Cable Systems To Rate Regulation

Congress in the 1992 Cable Act established a more stringent definition for effective competition (one that will subject many more cable systems to basic rate regulation) than the Commission's existing definition. According to the 1992 Cable Act's legislative history, the Commission's effective competition

definition (which itself was redefined in 1991 to be made more stringent) only subjected approximately 20 percent of cable systems to basic rate regulation.[7] In contrast, the Commission estimates "that only a tiny percentage of the approximately 11,000 cable systems nationwide face effective competition, as that term is defined by the 1992 Cable Act."[8] Instead of 20% of cable systems being subject to rate regulation, Congress' new definition of effective competition, according to the Commission, will subject up to 75 percent of cable systems, serving approximately 75 percent of subscribers, to both basic and non-basic (cable programming service) rate regulation.[9] Such a drastic increase in the number of cable systems subject to regulation, coupled with the fact that both basic and non-basic rates are now subject to regulation, suggests that the 10 percent benchmark rollback requires no additional punitive effect.[10] Indeed, the Act's legislative history reflects Congress' belief that the toughened effective competition test, coupled with the

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[7]H.R. Rep. No. 628, 102d Cong., 2d Sess. 30-34 (1992).

[8]Report at n.30.

[9]Id. at ¶ 15.

[10]The Commission's rules implementing the rate regulation provisions of the 1992 Cable Act provide for cable rate reductions of up to 10 percent below levels in effect on September 30, 1992. 47 C.F.R. § 76.922(b)(1)(iii). These regulations also forced cable operators to freeze their rates from April 5, 1993 to August 3, 1993. Id. at § 76.900. The Commission has now extended the rate freeze until November 15, 1993.

statute's stringent rate regulations, "will provide consumers meaningful protection from unreasonable cable rates."[11]

Moreover, the 10 percent rate reduction is justified by the Commission based on its finding that "[t]he comparison of rates of systems subject to effective competition and those not subject to effective competition based on data from all these systems produces a competitive rate differential of approximately 10 percent."[12] Further narrowing the sample of systems to only those facing effective competition under other tests besides the 30 percent penetration test would have no such purported rational basis, and thus would likely be struck down by the courts. At minimum, the Commission should not order further reductions until the full effects of the 10 percent reduction on subscribers and the cable industry can be analyzed. As is discussed below, it is already evident at this early stage that such effects have been disastrous.

In sum, Congress has clearly specified three situations where cable systems are deemed to face effective competition. If any one of the standards is met, competition is presumed to exist, and the resulting rates must therefore be presumed to be competitive. Congress could have mandated regulation of rates in systems that did not face effective competition, but it chose not to do so. Indeed, Congress greatly strengthened the existing

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[11]H.R. Rep. No. 628 at 34.

[12]Report at ¶ 560.

definition of effective competition, and in so doing, expressed its belief that the new definition and new rate regulations would provide protection against unreasonable rates. Accordingly, the Commission has no authority to discount or ignore the 30 percent penetration standard merely because it yields higher rates than the other two effective competition standards.

II. FURTHER FCC-MANDATED RATE REDUCTIONS WOULD HAVE DISASTROUS EFFECTS ON THE CABLE TELEVISION INDUSTRY

A. The 10 Percent Rate Reduction Understates The Actual Reductions That Many Cable Operators Will Suffer.

The 10 percent figure greatly understates the real revenue reduction for many cable operators. As described above, the 10 percent maximum rate reduction mandated by the Commission's new rules is not subtracted from cable rates current as of the effective date of the rules. Rather, it is subtracted from cable rates as of September 30, 1992.[13] Accordingly, any cable operators who increased their rates after September 30, 1992, no matter how legitimate or necessary such increases were (e.g., because of increased costs), must reduce their rates more than 10 percent (i.e., 10 percent plus the amount of increase since September 30, 1992).

Moreover, even after reducing rates up to 10 percent off their September 30, 1992 rates, cable operators must deduct their

[13] 47 C.F.R. § 76.922(b)(1)(iii).

equipment costs to arrive at the maximum permitted rate.[14] If a

demonstrates that many cable operators will suffer a revenue reduction of much more than 10 percent under the new rules.

B. Even The 10 Percent Rate Reduction Stands To Devastate The Cable Television Industry.

As has been widely reported, even a 10 percent rate reduction will have drastic repercussions on the cable industry. These negative effects have already begun to be felt. There are two principal areas where the cable industry is being especially hard hit by the Commission's new rate regulations:

1. Loss of Financing and Capital.

Because of the announced and threatened rate reductions, it is also becoming much more difficult for cable operators to raise needed capital. On April 2, 1993, the day after news of the rate regulation was released, the value of cable stocks dropped up to 20 percent from their level of only a few weeks earlier.[18] Not surprisingly, two weeks later Jones Intercable announced that due to the new regulations, the partnership's cash distribution policy to its investors would have to be "reevaluated" on a quarter by quarter basis.[19] It is fully expected that many more

[18]Compiled by Mark J. McGarry, "Short Cuts," Newsday, May 6,

cable operators will feel the financial squeeze from the Commission's rate rules.

2. Reduced Investment in New Programming and Physical Plant.

The loss of access to capital will hinder cable's evolution towards its 500 or more channel potential. This will delay the introduction of interactive programming as well as an almost unlimited variety of other programming services. According to TeleCable CEO Richard Roberts, reregulation could delay the telecommunications future of cable because "a projected 10 percent loss of revenue and 20 percent drop in working cash will make it hard for some operators to upgrade [their] systems."[20] In fact, currently, there are more than 40 new programmers who are waiting for cable operators to add the channel capacity to carry them. The Commission's rate regulations will undoubtedly cause further delays in launching such services. Mark Riely, partner of the communications investment firm McDonald, Grippo and Riely believes that, because of the new cable regulations, any new cable network will be forced to undergo a protracted start-up phase of at least five years before they will be carried over a large number of systems.[21] The Wall Street Journal reports that "[c]able operators may be all the warier of new

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[20]"Force 9 Hurricane: Cable Boning Up on Telecommunications Regulation," Communications Daily, May 24, 1993, at 2-3.

[21]Christopher Stern, "New Channels Scramble for Space," Broadcasting & Cable, June 7, 1993, at 38.

channels from unknown providers because of the expected financial hit from the new federal restrictions on cable rates."[22]

According to Jim Wholey, Washington representative for Jones Intercable, his company's biggest concern is how to reconcile the Commissioner's rate rulemaking "with [our] desire and [the] congressional mandate to invest in upgrading our plant and services."[23] Likewise, according to the National Cable Television Association, the cable industry had planned to invest $14.7 billion in plant and equipment upgrades between the years 1992 and 2000.[24] With drastically reduced revenues from subscriber fees and less capital investment from financiers resulting from the current rate regulations, it will likely be impossible to maintain this level of investment.

could mean banks will force the cable companies to restructure their loans, pay higher interest rates, and cut spending on technology and equipment.[25] This view is shared by John Mansell, a cable analyst with Paul Kagan Associates, who states, "[i]f I was out there as the owner of a small cable system, I'd seriously be thinking of selling my business."[26] Telecable CEO Richard Roberts concurs: "At the moment we are in the midst of a Force 9 hurricane. Survival is not compulsory. Some systems in their current form will be unable to cope."[27] With many cable companies facing financial ruin as a result of the 10 per cent rate cut, it is clear that almost tripling that cut to 28 percent will send many cable operators over the brink into bankruptcy. Surely, this was not the result intended by Congress.

Nor was it the result intended by the Commission. In ordering a maximum 10 percent rate reduction, even for systems whose rates were more than 10 percent above the relevant benchmark, the Commission specifically rejected steeper

Any action by the Commission now to force cable operators to reduce their rates by an additional 18 percent would directly contravene this concern expressed by the Commission only two months ago, and would create an intolerable financial burden for cable operators.

Moreover, such a step is unnecessary because the Commission has established a procedure to scrutinize so-called "outliers," those systems whose rates are well above the benchmark even after the maximum 10 percent reduction. Specifically, the Commission will gather "specific cost information from a sample of representative cable systems."[29] "In addition, systems that are substantially above the benchmark even after the rate rollbacks will be subject to special scrutiny through cost-of-service investigations."[30] Thus, the "outlier" approach will deal with systems having extraordinarily high rates on an ad hoc basis, rather than unfairly sweeping all cable operators in with further draconian and unwarranted rate reductions. In sum, the Commission has made a hypothesis about the 10 percent rate differential and its ability to identify and deal with "outliers." The Commission should test its hypothesis on a case-by-case basis before attempting to mandate further rate reductions which are overly draconian and unwarranted.

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[29]Id. at ¶ 220.

[30]Id.

D. The Commission Cannot Act In A Regulatory Vacuum.

The cable industry is a major contributor to the U.S. economy and infrastructure. For example, in 1991 the cable industry directly employed over 106,000 people,[31] as well as generating over 500,000 jobs for 1990.[32] Franchise fee payments to cities for 1993 are projected to reach over $ 1 billion, up from an estimated $917 million in 1992.[33] The cable industry's contribution to the GNP has grown to more than $42 billion, nearly 1 percent of the total GNP.[34] Taxes on cable television revenues also contribute greatly to the U.S. and individual state economies. For example, as of 1990, cable companies in Georgia paid $15 million annually in payroll and property taxes.[35] Thus, any Commission Action to curtail these contributions will have serious effects on local municipalities which have come to depend on franchising fees as a source of revenue, as well as on the national economy as a whole through loss of jobs and tax revenues. At a time when the cable industry (due to the Commission's new rate regulations) and the U.S. economy are both

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[31]1991 Broadcast and Cable Employment Report, FCC News Release, June 24, 1992.

[32]"Impact 90: A Report of Cable Television's Impact on the U.S. Economy," Bortz & Co. Inc., Jan. 1990, at 16.

[33]Cable TV Franchising Guide, Jan 31, 1991, at 3.

[34]"Impact 90" at 15.

[35]Compiled by the Community Antenna Television Association.

economically very vulnerable, any further rate reductions ordered by the Commission would have disastrous effects on both.

III. THERE IS NO EVIDENCE THAT A FURTHER RATE REDUCTION IS WARRANTED

A. The Commission Is Engaging In Prohibited Rulemaking By Result.

The Commission's sole rationale behind questioning whether to exclude the 30 percent penetration test from its rate calculations is that excluding such systems yields an approximately 28 percent rate differential, instead of 10 percent, between systems subject to effective competition (under one of the other two tests) and systems not subject to effective competition. In other words, rates were found to be higher in systems meeting the 30 percent penetration test than in systems meeting one of the other two effective competition tests. Therefore, the Commission seeks to exclude the 30 percent penetration test solely because of the result such test yields. The Commission does not demonstrate that the test is an invalid indicator of effective competition (nor does it have the authority under the statute to do so).[36] The Commission does not

[36]While the Commission speculates that low penetration might be due to other factors in addition to competing multichannel video distribution services, Report and Order at ¶ 561, the other two tests have similar flaws. For instance, cable overbuilds are often characterized by artificially low rates due to below-cost price cutting by the parties, which may end with one party selling out to the other or going out of business. See, e.g., "Economic Analysis of Cable System Overbuilds," Malarkey-Taylor Research (1987); "Report on Overlapping Cable Franchise Study,"

allege that its rate survey methods regarding this test were flawed. Indeed, the Commission's description of its survey indicates that the sample of systems meeting the 30 percent test is up to five times larger than the sample of systems meeting the other two tests,[37] which suggests that the 30 percent test may have yielded the most statistically valid sample.

Thus, any action by the Commission to order further rate reductions would be pure rulemaking by result, wherein the Commission determines the result desired, and works backwards to achieve that result without a valid reason for changing the rule. Such a method of rulemaking violates the Administrative Procedure

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Touche Ross & Co. (1987); Samuel H. Book, Ph.D., "Do Overbuilds Make Sense?" Cable Marketing, November 1987, at 34. Thus, such rates are artificially skewed downward and do not represent sustainable competitive rates. The Report and Order acknowledges this fact when it states that "the procedure assumes that prices are in equilibrium. If, for instance, some community units in competitive markets are facing price wars, their prices may be [illegible]

Act's requirement that the Commission's action, findings, and conclusions not be:

> (A) arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law; or
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> * * * *
>
> (C) in excess of statutory jurisdiction, authority, or limitations, or short of statutory right.[38]

While the Commission has adopted a Further Notice in this proceeding in the apparent hope that some commenter will provide it with a rationale for excluding the 30 percent test, it is difficult to imagine an agency action which is more arbitrary, capricious, and in excess of statutory authority than that contemplated in the Further Notice.

B. The 10 Percent Cut In Both Basic And Non-Basic Rates Is Draconian Enough Without Further Reductions.

In ordering a maximum across-the-board 10 percent rate reduction of non-basic service tier rates as well as basic rates,[39] the Commission appears to have exceeded its authority under the 1992 Cable Act. It is clear from the language of the Act and its legislative history that Congress did not intend the same degree of regulatory oversight for cable programming service tiers as for the basic level. By requiring franchising

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[38] 5 U.S.C. § 706 (1993). See also Farmers Union Central Exchange, Inc. v. F.E.R.C., 734 F.2d 1486, 1500 (D.C. Cir. 1984), cert. denied, 469 U.S. 1034 (1984).

[39] 47 C.F.R. § 76.922(b)(1)(iii).

authorities to implement local basic rate regulation pursuant to guidelines established by the Commission, Congress contemplated that rate regulation of basic service tiers would be the norm, not the exception, where cable systems are not subject to effective competition. In contrast, with respect to cable programming services, the statute limits the Commission's regulatory authority to establishing "criteria. . . for identifying, in individual cases, rates for cable programming services that are unreasonable."[40] Clearly, with respect to non-basic services, Congress contemplated that rate regulation would be the exception rather than the rule.

It is also evident from the legislative history of the 1992 Cable Act that rates for non-basic services were not to be subject to the same pervasive regulatory structure as basic service. The House Report states that:

> The Committee recognizes that since cable rates were deregulated in 1986, there has been an increase in the quality and diversity of cable programming. While most operators have been responsible about rate increases in this deregulated environment, a minority of cable operators have abused their deregulated status and have unreasonably raised subscribers rates.[41]

The notion that the "bad actor" test would apply to only a distinct minority of cable systems is also supported by floor statements made by some of the principal proponents of this legislation:

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[40]47 U.S.C. § 543(c)(1)(A) (emphasis added).

[41]H.R. Rep. No. 628 at 86 (emphasis added).